



UiO • Faculty of Law
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PhD seminar on Sustainability Law: Companies Markets
and Circular Economy

How to tackle financing problems of innovative and sustainable SMEs

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What are we talking of?

- EU Commission definition
 - micro, small and medium-sized enterprises (SMEs): employ fewer than 250 persons and have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million
 - small enterprise: employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million
 - microenterprise: employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million

What are we talking of?

- SMEs often ignored in corporate sustainability discussion
- Forgetting their
 - amount: 25 million in EU only
 - important role as MNEs
 - economic importance: 50% of EU GDP
 - role as employers: employing 100 million EU humans

Importance of SMEs

- Both globally and in locally the role of SMEs is however crucial for the society and the economy
 - Indeed, sometimes MNEs are SMEs!
 - Always part of local and also global value chains (GVCs)
 - Foreign investments by SMEs has increased and they play a significant role on the international scene
- ➔ SMEs a vital part of GVCs producing and distributing goods and services for consumers

Importance of SMEs

- Bigger than their size; they own valuable rights for the whole GVC, and sometimes they lead their own often narrow GVC

Role of SMEs in European economy

- [EU Commission SME Strategy](#) (2020)
 - Europe's 25 million SMEs are the backbone of the EU economy
 - SMEs employ around 100 million people, account for more than 50 per cent of Europe's GDP and play a key role in adding value in every sector of the economy
- SMEs crucial in value chains ([Corporate Due Diligence Directive proposal](#) [2022])

What are we talking of?

- Digitalisation, sustainability and circular economy
 - Almost 25% of SMEs in the EU enable *sustainability and circular economy transition* by offering ‘green’ products and services and contributing to social economy (European Commission, 2020)
- Most of the 10,000 European *digital platforms* are run by SMEs

Role of SMEs in sustainable innovations

- SMEs bring innovative solutions to challenges like climate change, resource efficiency and social cohesion and help spread this innovation throughout Europe's regions
 - ➔ SMEs central to the EU's twin transitions to a sustainable and digital economy
- SMEs essential to Europe's competitiveness and prosperity, economic and technological sovereignty, and resilience to external shocks

What are we talking of?

- On the other hand, SMEs cause
 - 70% of global pollution
 - 60% of global carbon emissions

SMEs are diverse

- Business forms
 - Companies in various forms
 - Private, public, listed
 - Partnerships and limited partnerships
 - Combinations of the above
 - Different kinds of cooperatives including multi-stakeholder cooperatives
 - From social and health to banking, transport and data governance
 - Mutuels etc.

SMEs are diverse

- Albeit mostly domestic more and more SMEs are multinational (MNEs)
 - OECD (2018)
- diverse in terms of business models, size, age, and entrepreneurs' profiles,
- range from agrifood and reindeer herding to liberal professions, from micros in the services sector to middle-range industrial companies, from traditional crafts to high-tech start-ups

SMEs are diverse

- Due to their vast number, a majority of *importers and exporters* in the EU are SMEs and within the group of SMEs the majority are micro-sized enterprises, followed by small and then by medium enterprises
 - For example, in Germany, the *Mittelstand* considered to be the backbone of the German economy
 - Yet, while large enterprises are a small minority of the number of enterprises in many countries account for the largest share in trade *value*

SMEs are diverse

- Only a small percentage of SMEs (some 0.6 million undertakings) are involved in internationalisation *beyond* the single market
- The single market accounts still for 70% of the value of SME goods exports, and 80% of all exporting SMEs sell to other Member States
- Only 17% of all manufacturing sector SMEs export within the single market
- The Single Market Barriers Communication (2020) shows that those most affected by continuing barriers, are SMEs

SMEs are diverse

- Digitalisation and innovations have made it easier for SMEs of all sizes to overcome some of the barriers to internationalization, and this trend is expected to continue
- What makes the SMEs special, there a correlation between sustainable social organisation and innovation
 - Collective ‘social capital’
 - Sustainable enterprises are built slowly by groups of people who collaborate over many years and not through the deliberate agency of visionary or ‘charismatic’ leaders or entrepreneurs

SMEs are diverse

- The most important barriers to more cross-border SME activity
 - *internal* barriers, such as the price of their own product or service and the high cost of internationalization
 - *external* barriers, such as lack of capital (estimated as EUR 20-35 billion), lack of adequate information, and lack of adequate public support and the costs of or difficulties associated with transport
 - Both barriers were more important the smaller the SME is

SMEs are diverse

- Competitive edge: the quality of goods and services as the competitive edge for SMEs
- Increasing the societal importance of SMEs: employ the most of European workers and contribute to local economies through their supply chains and tax payments

SMEs are diverse in industry

- Food production
 - Aquaculture
 - Agriculture
 - Apiculture
 - Reindeer herding
 - Other herding (goats etc)
- Non-indigenous and indigenous SMEs

Some are cooperatives but cooperatives are diverse

- In 2013: 160,000 cooperatives with 123 million member and 5.4 million employees
- Some SME cooperatives are indeed communitarian, serving the local people
- Some are multi-stakeholder
- Some are banks
- Some are traditional mono-stakeholder consumer, producer and worker cooperatives
- Especially in retail following MNE business model

SMEs are not diverse

- Financing
 - Rely heavily on banking finance (90%)
 - Blockholding as main rule also in listed SMEs
 - No ‘separation of ownership and control’
 - Members active in management and supervision
 - Albeit some SMEs are ‘communitarian’, most are not
 - Employee participation as members (multi-stakeholder enterprise)

SMEs are not diverse

- Need for joint public, private and hybrid investment in innovation and research
- Fully integrated capital markets can help mobilise finance for SMEs
- Public procurement

SMEs are not diverse, and are anyway

- All SMEs are part of global value chains
- Some are more tightly tied to the lead firm, some are not
- Some are networking
 - Public procurement as regulatory modality
 - A ‘force multiplier’

SMEs

- Albeit SMEs are enterprises with human faces, they require technology
 - Financing
 - Creating the edge on the markets
 - Innovation financing extremely crucial for them
 - Banks – no collaterals – no money – no honey (apiculture of course)

Major challenges of SMEs

- Lack of skills in sustainable business models
- Difficulty accessing public procurement
- Lack of finance
 - Dependence on bank financing
 - Lack of collaterals
 - Challenge regarding sustainable finance

What is the problem in regulatory frameworks?

- To decrease '[regulatory burden](#)' SMEs are exempted to many regulatory frameworks as [reporting and disclosure](#)
- We see this reflected in the European Commission's 2021 [proposal](#) for Corporate Sustainability Reporting Directive, excluding all but listed SMEs from the scope of the initiative
- Without offering suitable alternative tools to convince financiers and contractual parties of their ability to create sustainable value

SMEs and due diligence

- The importance of due diligence for SMEs is recognised for instance by the OECD in its due diligence guidelines for MNEs
- One of the most important issues in due diligence is a common understanding of it, in particular for SMEs, and how to encourage them to implement it in the supply chains they are part of
- In collaboration with other members of the chain

SMEs and due diligence

- Due diligence is important for all undertakings, regardless of their business form, control structure, sector, context of operations, nature of products or services, business model, position in value chain, and size
- The nature and extent of due diligence can however be affected by these factors
- For SMEs these factors are crucial, and create both challenges and opportunitys

SMEs and due diligence

- Albeit crucial for the European economy already today, the significance of SMEs is expected even to increase in the future
- The adoption of sustainable business models by SMEs is therefore of outmost importance
- Due diligence is here crucial

The regulatory failure

- No sufficient regulatory framework to support SMEs
- Regulation for various aspects of [sustainability due diligence](#), covering all environmental, social and governance aspects of the undertaking's activities, tends to exclude SMEs
- E.g. national initiatives, French [vigilance law](#), [German regulation](#) on supply chains, now adopted [Norwegian law](#) on business transparency
- This exclusion is in contrast to the [OECD guidelines](#), which otherwise have provided much inspiration for such legislative initiatives

Regulatory failure repeating itself on EU level

- We see this regulatory exclusion playing out at European level also recently with the European Parliament:
- [Urging](#) the European Commission to issue a legislative proposal in sustainable due diligence, but at the same limiting the scope of its initiative to listed and 'high-risk' SMEs only

Drivers for change

- According to the [results](#) of a recent consultation on the European Commission sustainable corporate governance initiative, an overwhelming majority (81%) of respondents expressed support for a broad EU legislative action for a sustainable due diligence duty

Drivers for change

- However, the Commission excluded SMEs from its sustainable corporate governance initiatives:
 - Corporate Sustainable Reporting Directive (April 2021)
 - Corporate Sustainable Due Diligence Directive (February 2022)

Time to include SMEs

- Unlike the Commission and the Parliament, many of the respondents recognized the special role of SMEs in due diligence
 - Encouraging the Commission to provide more help and advice in the form of toolboxes, helpdesks and guidelines to support SME due diligence capacity building
 - instead of SME exemptions

What to do

- Public support for entrepreneurs' personal commitment
- New ways for private direct financing
- And broadened and improved regulatory framework

Why SMEs are important

- Are their commitments to other organisations reciprocal and a source of opportunities for all network members?

or

Why SMEs are important

- are they unilateral in which one dominating organisation (a for-profit firm as a lead MNE, a large of super-large cooperative, or a public market actor, for instance a state as shareholder or a municipality as a procurer) subordinates the network in its private interest without need to internalize their private and social costs and causing a 'strategic failure' for the whole network?

Why SMEs are important

- Crucial question for SMEs' sustainability: do they have power enough to form their business model as sustainable in spite of unsustainable forces in the value chains and networks they are a part of, and are they able to fulfil the duty set to them by the European Commission to contribute to 'a climate neutral, resource efficient and agile digital economy'

Three crucial issues

- Business model
- Governance
- Finance

Business model

- Need to be ‘immune’ of investment model
 - How to create a sustainable business model with unsustainable finance
- GVCs a threat and a possibility
 - Possibility to create a SME MNE
- Technology as regulatory modality
 - Platform economy: who owns the data?
 - Amazon, Alphabet, Google, Uber, Airbnb
 - Technology on the other benefits SMEs (AI, IoT, 3D, cryptofinancing)

Governance

- A MNE ideal
 - for boards in MNEs corporate governance and sustaining and developing the undertaking's business model are essentially the same thing, both entailing the same goals and the same activities by the board, but with a tension

Governance

- Tension in MNEs
 - Governance: board as custodian of the shareholders' investment – shareholder value
 - Business model: taking responsibility for the undertaking's relationships with network ('stakeholders'), integrating accountability and compliance with strategy – sustainable value creation

Governance

- value creation, capture and delivery in network
 - Shareholders v network
- Corporate governance v business model:
reflected in accounting and reporting
 - when financial accounting focuses to measuring realisable value distributable to the shareholders, a business model thinking emphasises demand for an integrated approach to explain the business model and value creation of the undertaking
- Challenge of company law and corporate governance to break this tension

Governance and SMEs

- What shareholder primacy means in SMEs?
 - Direct participation of investors and members in management
 - ‘Stewardship’ takes different forms
 - Partnership, cooperative, closely held company
 - But do we still need independence in decisionmaking to prevent tunnelling of private interests to members, investors and ‘stakeholders’ as communities and workers?
- How ensure sustainable value creation instead stakeholder primacy?

Policy questions

- Taking into consideration the diverse nature of SMEs
 - Do the listed governance model (separation of ‘ownership’ and control) fit all?
 - Do we need a board?
 - Do we need board ‘indipendence’?
 - What is the role of limited liability?

Finance

- European Commission (2020): European SMEs face a ´finance gap in Europe of EUR 20-35 billion
 - This despite substantial support programmes at EU and national level, and
 - In some Member States, access to finance remains a key problem for SME
 - Food production

Finance

- Public private partnership crucial for SMEs
- Examples
 - European Innovation Council (EUR 300 million in 2020) for European Green Deal Investment Plan
 - InvestEU: European Investment Fund
 - Cryptofinancing (IPOs etc)
 - InvestEU + Horizon
- Lacking a comprehensive planetary boundaries vision

Finance

- SME banks as cooperative banks
 - Account 20% of EU bank deposits and loans
 - Finance one third of SMEs in Europe
 - Finland nearly 40% (OP)
 - The Netherlands over 40% (Rabobank)

SMEs and commodities markets

- Consumer markets
 - Shorter value chains: Food, transport
- Public procurement

Value chains

- Digitalisation
 - Eg distribute ledger technology (DLT)
 - Value chains
 - Finance
 - Governance
 - Farm to fork
 - Governance of common pool resources (data)

Policy question

- Access to data
- Public procurement
- Sustainable governance and finance

Policy question

- We see that we cannot leave the SMEs as underdogs
- That is why we need to take sustainability due diligence seriously
 - As the OECD in its MNE and DD guidance
- That is why we must take sustainability serious in reporting
 - Not like Commission in its proposal for corporate sustainability reporting directive

Policy question

- Instead of exclusions and SME-specific standards, scalability
- Instead of creating monopolies and oligopolies for data, co-governance
 - Reforms in competition law preventing cooperation, in public procurement giving preference to MNEs

Role of SMEs in sustainable innovations

- SMEs a core part of the achievement of the EU's industrial strategy
- For SMEs a positive association between ownership of IPRs and economic performance is particularly strong - the SMEs that own IPRs have a 68% higher revenue per employee than those with no IP rights

[\(2021 IP Rights and firm performance in the EU en. pdf \(europa.eu\)\)](#)

Role of SMEs in sustainable innovations

- The role of SMEs in utilization of IPRs is smaller than what could be expected
- Only 9% of SMEs protect their IP, as they are unaware of EU and national IP initiatives or fear the complexity and expense of acquiring and enforcing them

[\(2021_IP_Rights_and_firm_performance_in_the_EU_en.pdf \(europa.eu\)\)](#)

Role of IPRs in SME sustainable innovation

- Only 1% of the SME IPR owners own a combination of patent, trademark and design, whereas this portion among large IPR owners was 13%
([2021 IP Rights and firm performance in the EU en.pdf \(europa.eu\)](#))
- Therefore, this area should be improved to reflect better the needs of SMEs in incentivising sustainable innovations
- Here we look problems in financing intertwined to the IPR problem and role of regulation as obstacle or driver for a sustainable innovative SME business model

Obstacles and drivers for SME innovation

- IPR system as an obstacle
 - SMEs' weaker possibilities to exploit the potential value of their IPRs
 - SMEs' vulnerability in front of bigger firms' IPR infringements claims
 - prevents them from gaining the full potential in the sector of sustainable innovation
 - Due to the fast technological progress, it is often difficult to evaluate what kind of acts are considered as IPR infringements
 - ➔ the wide “grey” area of acts increases the risks for SMEs

Obstacles and drivers for SME innovation

- ➔ Lack of systematical proceedings on how to deal with innovations and IPR & lack of knowledge on IPRs ➔ losses
- The SMEs' limited possibilities to take risks might prevent them to innovate and utilize alone sustainable innovations or practices such as repairs and prevent utilization of elements from others' innovations etc

Obstacles and drivers for SME innovation

- The essence of intellectual property rights, exclusivity, does not support dissemination of sustainable inventions
- Infringement assessment is based on extensive rights & narrow limitations, which might not recognize the current societal need such as environmental sustainability
- IPR justifications (for instance: the utilitarian model) as such could support promoting sustainability. They also take neutral stance on right holders' position in the market or its size. However, many characteristics of IPRs are more beneficial for large companies and consequently, make IPRs more efficient tools for them

Obstacles and drivers for SME innovation

- Most important obstacle: **lack of innovation finance**
- Limited possibility to use innovations as collateral for bank funding
 - Bank finance 90% of SME financing
 - Banking finance makes the SMEs especially vulnerable as their main assets are intangible, innovations that are hard to be accepted as collaterals by the banks
- Limited possibility for crowdfunding
- Fierce competition on venture capital / private equity
- Public funding

Obstacles and drivers for SME innovation

- One of the main problems for financing is IPRs themselves
- The problem between intellectual property and financing is cumulative:
 - financiers as banks and venture capitalists are reluctant to finance intellectual capital and without intellectual capital there is no innovation and financing of innovation

Obstacles and drivers for SME innovation

- The situation has grown worse also in innovation financing during the pandemic
- Several attempts during the decades to support an innovative SME business model; examples

Role of regulation

- Innovative SMEs have been dear to regulation from the 1980s
- First trend was at universities to commercialise academic innovations for financial gain
 - Abandoning professor's privilege (faculty retain the right to control the intellectual property of their inventions) and going to university technological transfer offices (TTOs)
 - Starting with Bayh-Dole Act of 1980 (US) and spreading to Europe in early 2000s (2001-2007)
 - Exception: Sweden that retains professor's privilege

Results

- Although universities created TTOs with hopes of financial gain, many TTOs have retained losses in their commercialization activities and have not generated significant local economic development
- As IPRs is a costly process, and of all the patents and licenses a university issues, there may be a limited number of inventions that actually yield enough revenue to cover or surpass these costs

Results

- Creation of startups with academic entrepreneurs and universities as minority shareholders?
- Suspicion among private equity towards lack of university commitment
- Detrimental effect to the research atmosphere in universities

Role of regulation

- Attempts to lower market access for SMEs; in the EU
 - Lisbon Strategy (2000) to make the EU ‘the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion’ by 2010
 - A Small Business Act for Europe (2008) to reduce the administrative burden of SMEs and enhance their access to finance
 - ‘Think Small First – the Small Business Act for Europe
 - European Code of Best Practice

Role of regulation

- [Europe 2020 Strategy](#) (2020): how access to the single market ‘must be improved’ for SMEs
 - Simplifying company law and adopting initiatives enabling entrepreneurs to restart after failed business
 - The 2011 review of the ‘Small Business Act’ further emphasised the central role of SMEs in the Union economy
 - ‘Single Market Act’ (2011): reduction of administrative burden and overall regulatory burden ‘in particular for SMEs’

Role of regulation

- Establishment of the European Venture Capital Fund (EuVECA) in 2013 to ensure new and growing businesses more accessible finance and expertise and knowledge, business contacts, brand equity and strategic advice
- to ‘stimulate economic growth, contribute to the creation of jobs and capital mobilisation, foster the establishment and expansion of innovative undertakings, increase their investment in research and development and foster entrepreneurship, innovation and competitiveness’

Role of regulation

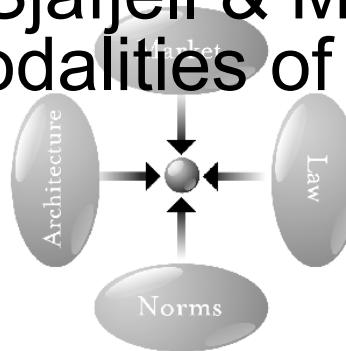
- Results: modest in the best
- Financial crisis and the pandemic has made the situation even more challenging
- Challenge: Can we find efficient innovation incentive mechanisms for SME sustainability?

Role of regulation

- Recent EU actions: Measures mentioned in 2020 IP Action plan and in the 2020 EU SME Strategy
 - For instance, finance for IP advice and IP registration fees, simplified (trademark) application system for applicants that do not use professional representatives
 - However it seems that the measures will (also) make protection stronger (for instance improving IP enforcement) – does it help?
- IPRs invisibility in the EU Circular Economy Action Plans

Role of regulation

- Reconsideration of regulatory ecological palette?
- Lawrence Lessig 1999; Maja van der Velden 2016; Beate Sjøfjell & Mark Taylor 2019: Four modalities of regulation
 - Law
 - Social Norms
 - Markets
 - Architecture
 - Natural and human



Role of regulation

- Possibilities of soft law mechanisms?
- Are SMEs vulnerable against soft law mechanisms dictated often by the big players?

Path to Change?

- “Lighter” / alternative protection mechanisms?
 - However, must be sufficient incentives
- Mechanisms to promote dissemination of innovations; open innovations etc
- Platforms? Owned by SMEs together? (sort of cooperative form)

Path to Change?

- Possibilities to create extra incentives for sustainable innovations and / or SMEs' innovations
 - However, avoiding incentives for remaining small
- Embedding sustainability into assessment of infringements
 - For instance, right to repair?

Path to change?

- Networking and PPPs:
 - SME networks can be re-networked as new organisational structures, including sustainable value chains involving both SMEs and large MNEs, with MNEs supplying infrastructure and capital, and SMEs providing the sustainability driven innovation engine that MNEs desire, for instance in public and hybrid procurement projects

Path to Change?

- Public promotion of SME innovation?
 - As a European example can be mentioned a *European Innovation Council* (EIC) initiative to promote disruptive innovation especially by SMEs, in which the Commission will allocate at least EUR 300 million in 2020 alone to high potential start-ups and SMEs for them to deliver breakthrough European Green Deal Investment Plan innovation

Path to Change?

- Provision of loans and venture capital through financial instruments
- In the Commission's recent [An SME Strategy for a sustainable and digital Europe](#) (2020) as examples are mentioned
 - a support for SME initial public offerings (IPOs) from the InvestEU programme,
 - a new ESCALAR initiative to boost venture capital and private equity with European Investment Fund co-financing (€1.2 billion),
 - a new gender-smart financing initiative to stimulate funding for women-led companies and funds and to empower female entrepreneurship,

Path to Change?

- a green tech investment initiative to pool funding from the EU, Member States and the private sector to increase access to equity finance for innovative SMEs and start-ups that develop and adopt green tech solutions
- a blockchain-based initiative enabling issuance and trading of SME bonds across Europe, using the European Blockchain Services Infrastructure, and
- a co-funding initiative for tech due diligence services to enable more precise valuations high tech start-ups and prepare their investment readiness

COVID-19 responses

- Competitiveness of Enterprises and Small and Medium-sized Enterprises (SMEs) (COSME):
Loan Guarantee Facility (LGF)
 - By 31 December 2021, more than 100,000 SMEs already received €9 billion of financing under the COSME LGF-Covid 19 measures

Or something totally different?

- From traditional finance (TradFi) to decentralised finance (DeFi)
 - OECD (May 2022): [Institutionalisation of crypto-assets and DeFi–TradFi interconnectedness](#)

Or something totally different

- [Blockchain Lab](#) (University of Oslo): Blockchain-based Equity Investment and Trading Platform
 - A blockchain-based platform for equity investment and trading in deep-tech startups
 - Contribute to the financing of deep-tech companies in the start-up phase
 - Give the mass market access to such investments
 - Based on decentralised blockchain technology
 - Earn/offer added value by offering good algorithms for valuing deep tech startups
 - Provide integrated AI-powered due diligence (automated de-risking) to startups

In the end of the day

- In spite of all these efforts
- Is it only the IPRs that play the role, how SME friendly they are?
- Additional regulatory issues
 - Financial accounting: how innovation is treated?
 - Emphasising transferable IPRs
 - Challenge: How can firms communicate the value of their innovative activities in their financial reports and beyond?

In the end of the day

- Global regulation (International Financial Reporting Standards) v. local standards?
 - How to encourage firms to disclose information on the company's business model with reference to its elements (inputs, processes and outputs), value creation, indirect wider consequences of the operation of the business model, etc?
 - Global regulation: IFRS Management Commentary? ISSB Sustainability Disclosure Standards (IFRS SDS)?
 - Local regulation: EU Revised Accounting Directive ([Corporate Sustainability Reporting Directive](#)) and EU Sustainability Reporting Standards (2022)

A SME support

- To enable SMEs' sustainable business models, the rules guiding them to sustainable value creation include *a scalability rule*, so that they are proportionate to the scale and complexity of the activities of the undertaking
- Scalability does not mean exemptions of the rules proposed but a general rule of simplified procedures in both due diligence

A SME support

- To enable full compliance, SMEs in both national and global value chains have the right to require the information necessary to fulfil the duties set to them from the controlling or lead undertaking of the value chain, whether it is a company law based parent company or contract based lead undertaking

A SME support

- Further, to ensure resources to fulfil the requirements proposed, we suggested an EU level SME Resource, consisting of an Advisory Hub and an Advisory Portal, to provide resources and advice to SMEs fulfilling their due diligence and reporting duties
- This resource could be part, for instance, of the [InvestEU Programme](#) for the European Green Deal and recovery from the pandemic

Conclusion

- With a combination of scalability in regulation and true support, SMEs can fulfil their due diligence and reporting obligations and thrive in the value chains of which they are part
- The European Parliament and the Commission deserve [respect](#) for their efforts to secure sustainable due diligence and corporate governance
- However, true progress necessitates that we consider all SMEs as important